No. 12,673

IN THE

United States Court of Appeals

For the Ninth Circuit

COLES TRADING COMPANY, a Corporation,
Appellant,

vs.

SPIEGEL, INC., a Corporation,
Appellee.

APPELLANT'S REPLY BRIEF

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ARGUMENT

I. Under the Contract Between the Parties, Spiegel Assumed the Obligation to Pay Excess Taxes.

It may be true, as Spiegel contends in more than seven pages of argument, that the words "subject to," do not, when dissociated from their context or under certain circumstances, mean "assume," but, as Mr. Justice Holmes said in *Towne v. Eisner,* 245 U.S. 418, 62 L.Ed. 372 (1918):

". . . A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used. . . ."

Here, the context of the contract, drafted by Spiegel*, and the performance of the contract by the parties, and even the testimony of Spiegel's attorney that, "we would except those things from the things that we took subject to," (R. 91, 92) clinches the argument of Coles that Spiegel assumed Coles' obligations under the lease:

(1) Spiegel and Coles annexed a photostatic copy of the lease to their contract, under a stipulation that the lease is *"a part hereof,"* (R. 17).

(2) Spiegel and Coles stipulated in their contract that *"notwithstanding"* anything in the lease governing such matters as the lessee's duties to make all necessary repairs and to perform promptly, the covenants of the parties on such matters in the contract should prevail, and they also stipulated for the termination of the contract on grounds different from those contained in the lease, (R. 17).

(3) Spiegel and Coles stipulated in their contract that Spiegel has thirty days of grace *"on matters other than rent,"* and this would be a meaningless covenant if Spiegel did not assume the lease obligations, (R. 17, 18).

(4) The transfer of the property by Coles to Spiegel under their contract was made *"subject to the terms of and with all the rights, privileges and benefits granted"* to Coles under the lease, (R. 17).

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*Coles does not quarrel with Spiegel's version that neither Coles nor his lawyer was present when the contract was prepared, since this version is less favorable to Spiegel than is the account given in Coles' Opening Brief.

(5) The contract between Coles and Spiegel obligated Coles to seek permission from the property owner *"to the subletting or assigning"* by Spiegel, (R. 19).

(6) Spiegel expressly acknowledged and performed the obligations of the lease governing insurance and heating, (R. 91).

Spiegel argues that the provision in its contract with Coles imposing an obligation upon Coles, "notwithstanding" anything to the contrary in the lease, to make structural repairs, does not indicate any intention by Spiegel to assume the lease, because, (according to Spiegel, Br. 15), the lease does not require Coles to make "structural repairs." This argument ignores the language of the lease specifically imposing the obligation upon Coles to make *all* necessary repairs and replacements (R. 7):

> "The Lessee . . . hereby agrees to keep the same in repair and good tenantable condition, making such replacements as may be necessary during the term of this lease."

Spiegel's argument that the provision in its contract with Coles imposing an obligation upon Coles to seek permission from the property owners for Spiegel to sublet or assign, is only a limitation upon the estate and binding upon the estate only (Br. 15), is fallacious in at least two respects: *First:* The obligation could be regarded as a limitation upon the estate only if Spiegel is the *assignee* of the lease, as Coles maintains, and as Spiegel denies; *Second:* Under Spiegel's theory that there is neither privity of estate nor privity of contract between Spiegel and the owner, Spiegel would not be precluded from subletting or assigning, for there is nowhere any promise by Spiegel not

to do so. If Spiegel had not assumed this obligation, then the insertion of the clause in question would have been an idle gesture.

Spiegel denies that the construction placed upon the contract by the subsequent conduct of Spiegel and Coles amounts to an acknowledgment by Spiegel that it assumed Coles' obligations under the lease, because (according to Spiegel, Br. 17, 18) Spiegel did not pay for liability insurance, and did not pay Coles' rent to the owner. This argument is unwarranted and fallacious in that: *First:* There is nothing in the record to show who, if anyone, paid for such insurance; and, *Second:* It is obvious from the contract between Spiegel and Coles that Spiegel assumed only such covenants in the lease which are not covered by its contract with Coles.

Spiegel points to a subsequent agreement between the parties (R. 78), under which Spiegel undertook to cure any default by Coles under the lease, and apparently jumps to the conclusion that the later agreement was contemplated when the basic contract between Spiegel and Coles was drawn up, (Br. 14). Not only is such a conclusion wholly without foundation, but the later agreement is irrelevant here, where the controversy concerns the very question of what amounts to a default.

II. The Contract Constitutes an Assignment, and Places the Burden on Spiegel to Pay the Taxes, as a Matter of Law.

By ignoring the distinctions between rules of contract and property law, and by dwelling upon the literal designation of the contract between Spiegel and Coles, Spiegel assumes, as did its attorney who drew the instrument, that the contract is a "sublease," and not an assignment, and

then chides Coles for designating the contract as an "assignment" (Br. 27). To support such assumption, Spiegel contends that Coles retained a "reversion" in the land, and that, in any event (says Spiegel), the parties intended to enter into a "sublease," and such "intention" should prevail over the legal effect of the instrument.

A. COLES DID NOT RETAIN ANY REVERSION.

Spiegel concedes (Br. 19) that the distinction between a sublease and an assignment is that a reversionary interest is retained under a sublease, and argues that a "right of entry" is a reversionary interest, and such "right of entry" exists under Section 27-1215, A.C.A. 1939, because (says Spiegel) the statute expressly provides such a remedy. Spiegel intimates that such a statutory "right of entry" was treated as a reversionary interest by the Indiana Court, in *Indian Refining Co. v. Roberts* (Br. 22).

Were it to be assumed (contrary to the fact) that a right of entry constitutes a reversion, Section 27-1215 would not be pertinent here, unless it be further assumed that the contract in controversy is a "sublease," for the statute applies only where there is a "tenant," paying "rent," under the provisions of a "lease." In other words, if, as Coles maintains, the contract is an assignment, the statute could have no application. By citing it, Spiegel begs the question.

The Indiana Court, in *Indian Refining Co. v. Roberts,* was not dealing with the Arizona statute, nor even with a law similar to the Arizona statute, because the Indiana law concerned situations where, unlike the Arizona statute, a landlord and tenant relation did not exist. Furthermore, the Indiana Court disagreed with Spiegel's contention that

a "right of entry" constitutes a reversion and flatly held that it did not constitute a reversion:

> "The right of re-entry is not an estate or interest in land; it does not imply a reservation of a reversion; it is a mere chose in action, and, when enforced, the grantor is in through the breach of condition and not by the reverter; it exists only as an incident to an estate or interest for the protection for which it is reserved. We hold that the right of re-entry on the part of Donn M. Roberts for the non-payment of rent on the part of appellant was not such a retention of a reversionary interest as to prevent the instrument in question from being an assignment."

Spiegel also argues that, because Spiegel has the option to terminate the contract in the event that the store is destroyed by fire,* Coles possesses a reversionary interest in the property. This argument is unsound, because a right of election in the grantee of an estate is not a "residue of an estate left in the grantor," under the statutory definition of "reversion" in Arizona.

Section 71-105, A.C.A. 1939, which defines estates in expectancy, says that:

> "A reversion is the residue of an estate left in the grantor or his heirs, or in the heirs of a testator, commencing in possession on the determination of a particular estate granted or devised."

Thus, a reversion is a future interest retained by the grantor by his act of transferring less than he owns to a grantee.

Unless Coles can be said to be the owner of a present interest in the property, he has no reversion, and the rela-

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*Or in the event of eminent domain.

tion of landlord and tenant does not exist between Coles and Spiegel.

Coles transferred to Spiegel all of its interest in the leased premises, and incidental thereto, extended to Spiegel a bare contractual right to cease payment and to return the property upon the happening of a remote contingency —destruction by fire. Surely, it will not be held that, by conferring such a contractual right upon Spiegel, Coles retained an estate in the land. The leasehold estate cannot *revert* to Coles. The mere possibility that the leasehold estate can be *transferred* by Spiegel to Coles, does not even constitute a legal possibility of reverter. The situation is the same as though Coles had been the fee owner of the land, and had sold the land to Spiegel, under an agreement that if the store was destroyed by fire, Spiegel could, at Spiegel's election, sell the land back to Coles for the amount of the original purchase price. In this example, as under the contract here under discussion, Coles might have an *obligation* to retake the property, but he would have no *right* so to do, and having no such right, Coles has no reversion or other interest in the land.*

If this contract were a sublease, Coles would be required to pay the taxes on the leasehold estate because Coles would then be the owner of the leasehold estate. However, Coles has sold the leasehold estate to Spiegel, without retaining

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*The *Indian Refining Co. case, ante,* cited by Spiegel is distinguishable, because there the assignee could terminate at any time, whereas Spiegel's right to terminate is subject to a condition precedent. A reversion is not subject to a condition precedent, *Restatement, Property,* Sec. 154. The instant case is similar to *Marathon Oil Co. v. Lambert,* 103 S.W.2d 176 (cited in appellant's opening brief, p. 18), where an instrument gave the so-called "sublessee" a contingent right to terminate, and the court held that the instrument was an assignment.

any ownership or interest therein. Spiegel is the owner of what was once Coles' estate and is bound to pay the taxes. This result flows, not from feudal technicalities, but from the consequences of rules of property law, based upon the ownership of land, clearly established during a period of five hundred years.

B. SPIEGEL'S ARGUMENT THAT THE PARTIES INTENDED AN ASSIGNMENT IS FALLACIOUS.

Spiegel argues that, even if there be no reversion in Coles, the contract must be treated as a sublease rather than an assignment, because the parties (says Spiegel) intended such result. This argument is replete with instances wherein the parties, and their lawyers, and others used the word "sublease" (as the contract is entitled) rather than the word "assignment."

This argument is worthy of consideration only if the law of Arizona makes an assignment purely a matter of intention, which it does not, because such result would constitute a clear departure from the common law. Arizona has adopted the common law as the rule of decision. *Collins v. Dye,* C.C.A. 9, 94 F.2d 799 (1938); *Ross v. Bumstead,* 65 Ariz. 61, 173 P.2d 765 (1946).

However, the contract itself demonstrates that the parties did not intend that Coles should retain any interest in the land; no right of re-entry was reserved for breach of covenant; Coles' sole remedy for nonpayment by Spiegel is an action for damages; no right was conferred upon Coles to terminate Spiegel's occupancy in the event of *any* contingency. Coles' rights are purely contractual rights, and are not property rights. The parties obviously intended that Coles would be Spiegel's creditor, and not

Spiegel's landlord. The mere fact that the parties are designated as "lessor" and "lessee" is less important than the fact that Coles surrendered complete dominion over the land.

Much reliance is placed by Spiegel upon a letter written by Coles' then attorney, but the letter, written several months after the transaction between Coles and Spiegel was closed, could not, and does not, show an intention to enter into a landlord-tenant relation. The attorney's only concern, as exhibited by his letter as a whole, was to prevent "rents" due to Coles from being eliminated by the later events. In other words, he was objecting to that type of an assignment which might authorize Spiegel to pay the lower rental directly to the landowner without paying any consideration to Coles for the transfer to Spiegel.

Spiegel's theory is extremely unusual, in that it comprehends that even though the contract is an assignment as to Coles, it is a sublease as to Spiegel: one transaction is broken down into two entirely different transactions, the effect of which depends upon which of the parties happens to bring the action—a sort of "double-faced" theory.

Ordinarily, legal relationships do not change with the party who looks at them. If A sells a chattel to B, and B sells it to C, the last two parties are seller and buyer as to A, as well as to B and C, and the last transaction is a sale "as to" all of them, and not a negotiable instrument or a false imprisonment.

But Spiegel contends that even though Coles has transferred away all its interest in the land, the relation of landlord and tenant may nevertheless exist between them. The question immediately arises, what land is Coles the

lord of? If, as seems clearly the case here, the owner of land transfers his entire interest to another, he can no more make himself a landlord than he can make himself an insurance company by merely calling himself one in the instrument of conveyance.

Because of its uniqueness, the origins of this "double-faced" approach may be worth looking into. Three cases are cited in Spiegel's brief as authority for the theory (Br. 19). Each relies almost entirely on what is the origin and foundation stone of the theory—dictum in the case of *Stewart v. Long Island R.R.,* 8 N.E. 200, 102 N.Y. 601 (1886). The plaintiff in that case had leased land to another for a term of fifty years and also contracted to sell the land to the lessee at the end of that time. The holder of the lease and contract to purchase then made a new lease to the defendant for a term of ninety-nine years. The plaintiff sued to recover the rent reserved in the original lease, and the defendant raised the objection that there was no privity of estate between them, on the ground that the latter instrument constituted a sublease. The court held that the agreement was an assignment despite the fact that it was intended to be a sublease. The principal issue was whether or not the equitable interest arising from the contract was a reversion sufficient to support a sublease. The majority of the court held that it was not such, and so the arrangement could not be a lease.

Only as a preliminary matter did the writer of the opinion in the New York case draw a distinction based upon whether the issue arose between the parties to the assignment or between the original lessor and the assignee (8 N.E. 201). It is upon these few sentences, completely un-

necessary to the decision, that all of Spiegel's citations are based.

There was a strong dissent in the *Stewart* case based principally on the ground that the equitable reversion was sufficient to support a sublease, but based also on the ground that intention should be allowed to control where it can possibly do so. It was the dissenter, therefore, who placed the greatest importance on the intention of the parties, not the majority.

Speaking of the difficulty of holding that the equitable title was not a reversion, that opinion contains this comment on the reservation of a "rent" in the assignment:

> "This difficulty is not answered by the cases which hold that, even where there is an assignment, the assignor may collect an excess of rent beyond what is due under the original lease, for such actions rest upon the express promise to pay, and not on an extinguished tenancy, and what is recovered is really not rent, but purchase price of the lease sold and assigned." (8 N.E. 211)

And referring specifically to the theory of the "double-faced" transaction, the opinion goes on to say:

> "Probably the doctrine referred to goes no further than, in case of an assignment, to preserve to the assignor some of his contract rights, but does not make him, at the same time a landlord and not a landlord." (8 N.E. 213)

It is precisely this that Spiegel is attempting to do. Since Coles has parted with all its interest in the land, the owner may treat Spiegel as its own tenant any time it should choose to do so. *Kewanee Boiler Corp. v. American Laundry Mach. Co.,* 7 N.E. 2d 461 (cited in appellant's opening brief,

p. 21). Under Spiegel's theory, Coles and the owner are each landlords of the same tenant and of the same tenancy. Spiegel contends that Coles has a right of entry for breach of covenant by virtue of the statute. The owner obviously has such a right by virtue of the assignment. Therefore, under Spiegel's theory, both would have a right to possession in the event of a breach by Spiegel—a highly confusing state of affairs. Coles respectfully submits that Spiegel has only one landlord, and that is the owner of the land.

The courts in some jurisdictions seem to have adopted the theory of the "double-faced" transaction without challenge, merely citing the *Stewart* case. Wherever any analysis was given to the matter, however, the courts have held otherwise: The theory was specifically rejected in *Weander v. Claussen Brewing Co.,* 42 Wash. 226, 84 Pac. 735 (1906) and in *Cameron Tobin Baking Co. v. Tobin,* 104 Minn. 333, 116 N.W. 838 (1908). In the latter case, as in the case at bar, the owner of land made a lease to the plaintiff. The plaintiff then "subleased" to the defendant for the remainder of the term, expressly reserving a right of entry for breach of any covenants. The defendant broke one of the covenants and the plaintiff brought an action of unlawful detainer. The court held for the defendant. By parting with all his interest in the land, the plaintiff became an assignor, and as such he could not enforce a right of entry, which exists only as an incident to a reversion. The plaintiff maintained that the existence of a landlord and tenant relation should be recognized despite the absence of a reversion, if the parties so intended, but this contention was rejected by the court:

> "Even if the question were de novo, with greatest difficulty only could the necessary conclusion from these premises be reconciled with general legal analo-

gies or with common sense. For, of necessity, on such a hypothesis, the right of entry would vest in two persons on breach of the covenant, viz., in the owner of the premises and in his lessee, who had assigned all his estate to the part of the premises involved. In consequence, the tenant in possession, on breach of covenant, would be subject at the same time, for the same wrong, in the same court, in the same form of action, to answer two different persons entitled to possession of the premises leased to him." (116 N.W. 840).

Spiegel's theory ignores the sound legal distinction between a lease and an assignment. It offers no solution to the problem of whether the instrument is a sublease or an assignment as to creditors of the parties, the government, or anyone beyond the parties thereto. Even as between the parties, it leaves the same question open until suit is instituted by one against the other, and then the solution turns upon which party first sues.

Spiegel's theory is tantamount to saying that when Smith and Jones stand side by side and watch an animal pass between them, the animal becomes a cat as to Jones, but as to Smith, it is an elephant. It is respectfully submitted that, in Arizona, a cat is a cat, an elephant is an elephant, a lease is a lease, and an assignment is an assignment.

CONCLUSION

For the reasons set out in this brief and in appellant's opening brief, Coles renews its request for entry of judgment in its behalf.

Respectfully submitted,

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